Investing: It’s never too early to start

By starting to invest early, even a small amount every month can turn into big savings through the powerful effect of compounding growth. Consider this example:

Jill begins investing $100 a month starting at age 23. By the time she’s 65, assuming a 6% annual rate of return, she will have accumulated $227,016. Ravinder waits until he’s 43 to begin investing, setting aside $100 a month. By the time he’s 65, he will have accumulated $54,622 (also at a 6% annual rate of return). In order to accumulate the same amount as Jill by age 65, Ravinder would need to quadruple his monthly investments.

<table>
<thead>
<tr>
<th></th>
<th>Starting Age</th>
<th>Investment/month</th>
<th>Years</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jill</td>
<td>23</td>
<td>$100</td>
<td>42</td>
<td>$227,016</td>
</tr>
<tr>
<td>Ravinder</td>
<td>43</td>
<td>$100</td>
<td>22</td>
<td>$54,622</td>
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As this example illustrates, the concept of compound interest works best over longer periods of time. The earlier you start, the more you can make from compound interest.
Six common investing pitfalls

Investing involves time, discipline and awareness. If you’re new to investing, knowing the pitfalls can help you to avoid making costly mistakes. Here are six common mistakes you’ll want to avoid.

1. **Not establishing an appropriate time horizon**
   One of the benefits of beginning to save and invest when you’re young is that you have a long time horizon—meaning your money can earn investment income for a long time before you need to access it. You can also take more risk with your money, because you have more time to ride out the market’s ups and downs.

2. **Lack of proper portfolio diversification**
   Different asset classes, industry sectors and geographic regions generally don’t move in sync with each other, and no one can predict exactly which type of investment will outperform the other. By spreading your savings among a variety of investments—a strategy called asset allocation—you’ll minimize your exposure to risk in any one industry or asset class, and smooth out your returns over the long run.

3. **Not knowing your risk tolerance**
   All investing involves some risk. It’s important to remember that in the investment world, higher risks are generally associated with potentially higher rewards, and lower risks with potentially lower returns. To determine how much risk you can afford to take on, think about how sensitive you’re likely to be to value or price fluctuations, and consider the rate of return you’ll need to meet your financial goals.

4. **Not rebalancing your portfolio**
   Once you’ve determined your portfolio’s asset allocation, it’s important to maintain this mix over time. Movement in the market can cause your allocation to drift from its original weightings. Rebalancing is an effective way to keep your portfolio aligned with both your investment objectives and your risk tolerance.

5. **Trying to time the market**
   Studies show that timing the market, or trying to predict market activity, simply doesn’t work. Markets inevitably experience periods of growth and correction, which can’t be anticipated—and exiting the market when it drops may mean you’ll miss out when it peaks. The best advice? Set up a sensible portfolio asset allocation, stick with your long-term plan and revisit it regularly to ensure it continues to meet your needs.

6. **Investing with your emotions, not your head**
   Investing is a marathon, not a sprint. It’s tempting to get caught up in media hype, and follow a panicked crowd to buy or sell investments at the peaks and valleys of the cycle. Rather than letting emotions drive your investment decisions, take a long-term approach and work with your MD advisor to create a portfolio that can weather market volatility.
Building your portfolio

Now that you know the reasons to invest and the pitfalls to avoid, it’s time to choose some investments for your portfolio. With countless types of investments available, building a financial portfolio can be a daunting task. While your MD advisor can help you create a well-diversified portfolio, it’s important to know the different types of investments that are available to you, and understand how they can affect your portfolio returns.

Bonds
A bond is an IOU; with a bond, you are lending money to a government, municipality, corporation, federal agency or other entity, known as an issuer. The issuer sets the terms of the bond, including the interest rate and maturity date. In return, the issuer gives you interest on your money and eventually pays back the amount you lent out. Bonds offer stability (if held to maturity) and regular income, but generally provide only modest returns.

Stocks
When you buy stocks, or equities, you become a part owner of the business, and you may receive a portion of any profits that the company allocates to its owners—those portions are called dividends. You can also benefit, in the form of capital gains, when the stock price of the business’s shares goes up. While stocks can provide relatively high potential returns, they are volatile and can fluctuate on a daily basis. There’s always a risk that you could lose some or all of your investment.

Mutual funds
A mutual fund is an investment fund that’s operated by a company that pools money from various investors and then invests that money in stocks, bonds, money market securities or other types of investments. These assets are managed by a professional money manager who selects securities based on a specific strategy—stocks in certain industries or countries, for example. Mutual funds offer the advantage of diversification (more than an investor could get by trying to invest $100 a month directly into stocks or bonds), and reduced risk.

Cash
Cash and cash equivalents, such as treasury bills, money market funds or guaranteed investment certificates (GICs), are suited for short-term savings goals. They are generally the safest type of investment, but tend to offer the lowest returns.

Alternative investments
Alternative investments are products that don’t fit into the three traditional asset types (stocks, bonds or cash). Alternative investments can include hedge funds, real estate investment trusts and commodities, among others. They’re often high-risk investments, best suited for investors with specialized knowledge. When you’re first starting out, it’s best to work with your MD advisor to build a solid foundation for your portfolio, based initially on the more traditional asset types.
Three questions to ask yourself before you invest

Before you start investing, you need to understand why you’re investing and what type of investor you are. Understanding your financial needs—and having a plan to meet those needs—can help you get to where you want to be.

1. What do I want to achieve with my money? (time horizon)
   Before creating your investment portfolio, you need to decide what your objectives for your money are. Of course, you want your money to grow, but, depending on what the money is designated for—retirement versus a vacation, for instance—the investments you choose will vary. For example, if you have a short-term goal, such as saving for a vacation or a down payment on a house, you may consider GICs or money market mutual funds.

2. What’s my attitude towards risk? (risk tolerance)
   In other words, how comfortable are you with the idea of losing money? Higher risks are generally associated with potentially higher rewards, and lower risks with lower returns. No matter how low risk an investment is, however, there’s always the chance you won’t get back as much as you invested. Always make sure you’re comfortable with the level of risk that’s built into your portfolio.

3. Do I have a mix of investments in my portfolio? (diversification)
   To reduce risk, it’s important to diversify your investments across a range of asset classes, as well as across industry sectors and geographical areas. A well-diversified portfolio is better able to withstand market volatility.

Get started now

By making the commitment to start an investment plan, you’ve already taken the hardest step. The next step is to call an MD advisor to develop your plan—it won’t cost you a thing. Your MD advisor can provide advice and guidance to help you create an investment portfolio that fits both your short-term and long-term needs.

Contact MD today.
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